IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

SUR TAX REFERENCE No 7 of 1983

For Approval and Signature:

Hon'ble MR.JUSTICE R.BALIA. and
MR.JUSTICE A.R.DAVE

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1. Whether Reporters of Local Papers may be allowed to see the judgements? Yes

2. To be referred to the Reporter or not? Yes b referred to the Reporter or not? Yes be referred to the R porter or not? Yes be referred to the Reporter or not? Ye be referred to the Reporter or not? Yes be referred to the Reporter or not? Yes be referred to th Reporter or not? Yes be referred to the Reporter or not? Yes be referred to the Reporter or not? Yes be referred to the Reporter or not? Yes be referred to the Reporter or not? Yes be referred to the Reporter or not? Yes be referred to the Reporter or no ? Yes be referred to the Reporter or not? Yes be referred to the Reporter or not? Yes be referred to the Reporter or not? Yes be referred to the Reporter or not? Yes be

3. Whether Their Lordships wish to see the fair copy of the judgement? No

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? No

5. Whether it is to be circulated to the Civil Judge? No

COMMISSIONER OF SUR-TAX

Versus

CELLULOSE PRODUCTS OF INDIA LTD.

Appearance:

MR MANISH R BHATT for Petitioner

SERVED BY RPAD - (N) for Respondent No. 1

CORAM : MR.JUSTICE R.BALIA. and
MR.JUSTICE A.R.DAVE
Date of decision: 17/12/98

ORAL JUDGEMENT (per R. Balia, J.)

The Income Tax Appellate Tribunal, Ahmedabad Bench 'C', has referred the following two questions of law arising out of its appellate order dated 13.4.1981 under the Companies (Profits) Surtax Act, 1964.

"1. Whether, on the acts and in the circumstances of the case, the appellate tribunal has been right in law in cancelling the order of the Commissioner of Sur-tax made u/s 16(1) of the Companies (Profits) Surtax Act, 1964?

2. Whether, on the facts and in the circumstances of the case, the amount of general reserves for the purpose of capital computation was not required to be reduced to the extent of the amount allowed in view of Rule 1(3) of the Second Schedule to the Companies (Profits) Surtax Act, 1964?"

2. The facts giving rise to the present case are that in original assessment under the Act of 1964, the assessee was granted depreciation and development rebate in computation of its income chargeable to tax under the Income-tax Act on the basis of the book value of the assets. In computing the capital of the company for the purposes of computing surtax payable under the Act, the amount of general reserve referable to depreciation and development rebate was not reduced as required under Rule 1(C) of the Second Schedule to the Surtax Act. Considering this to be prejudicial to the interests of revenue, Commissioner of Surtax, in exercise of his powers u/s 16(1) of the Act of 1964, set aside the order of ITO and directed him to make a fresh assessment reducing the reserves to the extent they are related to deduction allowed on account of depreciation and development rebate in computation of taxable income.

3. On appeal, contention was raised on behalf of the assessee that even if the difference of Rs. 8,45,285/as pointed out by the Commissioner in his order is correct and represents as excess capital, against this a sum of Rs. 10,39,500/- has been declared by way of dividends so that no amount of excess stands credited to the reserve account and it was also pointed out that unappropriated

profit has not even been taken in present case to the reserve account. Therefore, in effect, no prejudice was caused to the interests of the revenue, and that being so, the order of the Commissioner u/s 16(1) could not be sustained for the reason that the Commissioner acquires jurisdiction u/s 16(1) not merely on the finding that the order is erroneous in some respect but only in case that it is also prejudicial to the interests of the revenue.

4. This contention of the assessee found favour with the tribunal and the order of the Commissioner has been set aside solely on that ground.

5. So far as the principle is concerned, there cannot be any doubt that u/s 16, before the Commissioner can revise the order passed by the ITO, he must satisfy himself by examining the record of proceedings on two counts, firstly, that the order is erroneous and, secondly, that it is prejudicial to the interests of the revenue. If the order is not erroneous, the question of exercise of jurisdiction u/s 16 simply does not arise notwithstanding that the order is against the interest of the revenue; so also even if the order is erroneous and it is not prejudicial to the interests of revenue. For example, when no loss of revenue is caused by such error, the Commissioner will still have no jurisdiction to correct that error by having recourse to his power u/s 16.

6. In the present case, we need to examine in brief, before considering the question whether the error found by the Commissioner could be said to be prejudicial to the interests of revenue, some salient features of the scheme of the Act.

7. Section 4, which is a charging section, subjects a company for every assessment year commencing on and from first day of April 1964 to a tax called as sur-tax in respect of so much of its chargeable profits of the previous year or previous years, as the case may be, as exceed the statutory deduction at the rate or rates specified under the Third Schedule. The two component features of the object of tax are 'chargeable profits' and 'the statutory deduction' to be deducted therefrom have been defined u/s 2(5) and 2(8) respectively.

8. Sub-section (5) of Sec. 2 defines "chargeable profits" to mean "the total income of an assessee computed under the Income-tax Act, 1961, for any previous year or years, as the case may be, and adjusted in

accordance with the provisions of the First Schedule". We may notice here that no error has been found in computation of chargeable profits within the meaning of Sec. 2(5) of the Act by the Commissioner.

9. Under section 2(8), "statutory deduction" has been defined to mean " an amount equal to ten per cent of the capital of the company as computed in accordance with the provisions of the Second Schedule, or an amount of two hundred thousand rupees, whichever is greater". There are two provisos to this section with which we are not presently concerned. The definition of statutory deduction makes reference to capital of the company as computed in accordance with provisions of the Second Schedule. This takes us to the Second Schedule. It enumerates number of amounts which are to be aggregated to arrive at the capital of the company concerned for the purpose of determining deductible amount from the chargeable profits computed under First Schedule to arrive at the final taxable chargeable profits to be subjected to surtax. The relevant provision which concerns us is sub-clause (iii) of clause 1, which reads,

(iii) "its other reserves as reduced by the amounts credited to such reserves as have been allowed as a deduction in computing the income of the company for the purposes of the Indian Income-tax Act, 1922 or the Income-tax Act, 1961".

This clause in its uninhibited form means that where any sum is allowed as deduction while computing taxable income under the provisions of the Income-tax Act, and such allowance of expenditure or rebate is referable to any amount credited to a reserve fund, then the reserve, to the extent such deduction has been granted while computing taxable profit under the Act, has to be reduced for the purpose of finding capital of the company for the purpose of computing statutory deduction. The reason is obvious. While granting deduction from chargeable profit, the total taxable profits are reduced by that amount and if the same amount as forming part of the reserve is aggregated with the capital resulting in increase in the capital amount for the purpose of computing statutory deduction which would necessarily result in increase in the amount of statutory deduction, will result in double benefit in respect of same sum, once by reducing the chargeable profit, the balance of which alone is to be taxed after reducing it from the statutory deduction, and by the very sum increase in the amount of deduction by allowing the increase in the capital of the company to that extent.

10. The provision being clear, it cannot be gainsaid that if the amount has been deducted from profits chargeable to tax under the provisions of the Income-tax Act and at the same time, for the purpose of claiming that deduction, such amount has been transferred to reserve fund, then on the basis of entries in the book, such reserve fund, to that extent, cannot be added in the capital of the company again. To that extent it does not appear that there is any dispute that there has been an error in the order of assessment. In fact, order of the tribunal proceeds on that assumption, without actually finding whether any sum deducted in computing taxable income, has in fact been credited to reserve fund, so as to require deduction under above clause.

11. As we have noticed above, if, by reducing the reserve fund by the amounts credited to such reserves for claiming development rebate by creating reserve fund for that purpose and the same has not been reduced from its capital, the inflated amount of capital of the company will result in inflated computation of statutory deduction which in turn would additionally reduce the balance of profits chargeable to surtax directly resulting in reducing the liability of surtax. In our opinion, the conclusion is inescapable that such an error is an error ordinarily which is prejudicial to the interests of revenue. In order to extricate from this position, the assessee has referred to declaration of dividend more than the amount of excess additions allowed to be made in computation of capital of the company as a result of the error noticed by the Commissioner. However, the tribunal has not made any attempt to show as to how this declaration of dividend has any bearing in offsetting the loss of revenue caused on account of the error noticed by the Commissioner in excess computation of the capital. It does not appear from any provision of the Act prima facie that the declaration of dividend is liable to influence computation of chargeable profits or statutory deduction in any manner. We cannot dwell on assuming hypothetical existence of certain facts which are not found or stated by the tribunal in its order. Suffice it to say that merely setting aside of the order and directing the ITO to aggregate the computation of capital and give effect to it would not preclude the assessee from following his remedies if he is aggrieved of any other error in the order provided such remedy is available to him in that regard under the relevant provisions of law. In absence of any factual material about the declaration of dividend, its nature and its relation with the reserve fund, we are unable to take

note of it for the purpose of arriving at a finding that the error caused in the assessment order is still not prejudicial to the interests of the revenue because of some other reason. Where oordr is found to be erroneous as well as prejudicial to revenue, and, there is no clear indication to contrary, exercise of jurisdiction cannot be held to be ultra vires.

10. We, therefore, answer Question No. 1 referred to us in negative, that is to say, against the assessee and in favour of the revenue.

11. We may also notice here that sub-section (3)(a) of Sec. 34 of the Income-tax Act, 1961 provides as a condition for allowing deduction on account of development rebate that an amount equal to seventy-five per cent of the development rebate to be actually allowed is debited to the profit and loss account of the relevant previous year and credited to a reserve account to be utilised by the assessee during a period of 8 years next following for the purposes of the business of the undertaking, other than for the purposes referred to in that provision. Thus, the allowance of development rebate is directly linked with crediting at least 75% of actual allowance to a reserve account of the company. It is that amount which is credited to the reserve account and directly related to the amount of deduction under the I.T.Act which is to be reduced from the said reserve. Likewise in the case of depreciation, if a company is maintaining a reserve account and depreciation is charged to that reserve account, such reserve will have to be reduced by the amount of depreciation charged to that year and allowed as deduction in computing the amount of profits chargeable to tax under the Income-tax Act. We accordingly answer Question No.2 as aforesaid.

11. The assessee has not appeared in spite of service. There shall be no order as to costs.

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